3. **The Banking System (Group 3)**

Critical Ideas - What do banks do? How do banks make money? What are bank reserves? What happens during a bank run? What does the Federal Reserve System do?

Question: How did the bank system contribute to the Great Depression?

Source 16: Letter to Bank President (1933)
(from https://www.stlouisfed.org/great-depression/curriculum.html)

February 1933

Dear Mr. Haralson,

Auditors of our bank have found some areas of concern in the bank's portfolios. We have, per your suggestion as our bank president, invested heavily in the stock market. Since Oct. 29, 1929, the value of our investments has declined sharply. Because of this, will we be able to meet our customers' financial needs?

The newspaper this morning reported that the U.S. unemployment has risen to 25 percent. In our city, unemployment is even higher. Businesses to which we have made loans are closing and firing workers. Home mortgage payments are staying the same, yet many of our customers in this time of high unemployment and low prices are unable to repay their loans, due to the loss of income. We have had to foreclose on many home loans and, because of the flood of houses on the market, we find that we're taking possession of worthless properties that nobody can afford to buy.

These factors concern this bank's board of directors. Please let us know what the plans are to make sure that our bank stays solvent and a good citizen of our community.

Sincerely,

Taylor M. Wydown

Chairman, Bank Board of Directors

Source 17: Typical Bank Balance Sheet (1933)
)from https://www.stlouisfed.org/great-depression/curriculum.html)

DEPOSITS	
Name	**Amount**
John Ellis	$4,500
Shermone Thomas	$3,000
Yadaf Gopolan	$5,000
Michaela Chepikov	$7,000
Angela Marstall	$6,000
Elaine Gifford	$3,500
Ruth Walls	$10,000
Bella Winston	$5,000
Total Deposits	**$44,000**
LOANS	
Name	**Amount**
Marc Taylor	$7,500
Elise Golden	$3,500
Raymel Starks	$4,000
Alexi Bourdavich	$10,500
Sandra Chou	$5,000
Barkly Kannenberg	$7,000
Total Loans	**$37,500**
RESERVES	
Total Deposits	$44,000
– Total Loans	$37,500
Reserves	**$6,500**

Source 18: Number of Bank Suspensions in the U.S. (1921-1936)
From Federal Reserve of St. Louis

TABLE 1.—NUMBER OF BANK SUSPENSIONS, 1921–1936, BY GEOGRAPHIC DIVISIONS, STATES, CLASSES OF BANKS, AND YEARS

ALL BANKS[1]

Geographic division and State	Number of suspensions															
	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936
United States—total	**505**	**366**	**646**	**775**	**618**	**976**	**669**	**498**	**659**	**1,350**	**2,293**	**1,453**	**4,000**	**57**	**34**	**44**

Source 19*: Photo February 22, 1932*
Crowds of depositors gathered outside of the banks after Clearing House Association announced withdrawals would be limited to five per cent of deposits. The crowd shown above is gathered in front of the Guardian Trust Company and National City Bank. The imposition of the withdrawal rule, which is for an indefinite period, followed steady runs on the banks as a result of the moratorium declared a week ago in Michigan

Source 20: Federal Reserve System
(From http://www.phil.frb.org/education/history/history_of_Banking4.html)

THE THIRD CENTRAL BANK:
THE FEDERAL RESERVE SYSTEM

The Federal Reserve System was not initially thought of as a central bank. Indeed, much of the legislative debate in 1913 about establishing the Fed was about whether the Federal Reserve would be a central bank or a collection of Reserve Banks. Initially, the Fed operated as a system of Reserve Banks, with a substantial amount of decentralized decision-making. In the 1920s, for instance, some Reserve Banks sold Treasury securities at times when other Reserve Banks were buying Treasury securities.

To improve the coordination of such open market purchases and sales of securities, the Reserve Banks eventually formed the Open Market Committee in the 1920s. This was the predecessor of today's FOMC (Federal Open Market Committee), which was established by congressional action in the Banking Act of 1935. The FOMC conducts monetary policy as we know it today. Congress put all seven members of the Federal Reserve Board of Governors on the FOMC and limited the Reserve Banks to only five voting members at any one time.

Unlike the First and Second Banks, the Federal Reserve does not make business loans or accept deposits from the general public. Instead it is a "bankers' bank," holding deposits and making loans only to depository financial institutions. Like the First and Second Banks, however, the Fed issues notes that circulate as currency. Also, just as its predecessors had branches, the Fed has 12 Reserve Banks plus a total of 25 Branches throughout the country.

Like the nation's two previous central banks, the Fed is the federal government's fiscal agent, receiving its revenues, holding its deposits, and making its payments. Originally, the third central bank also had only a 20-year charter from Congress. But the McFadden Act of 1927 gave it permanence. So, unlike its predecessors, the Fed has lasted beyond its initial charter period. National banks and those state-chartered banks that choose to be members of the Federal Reserve System receive non-tradable stock in their District Reserve Bank, in contrast to the publicly owned and traded stock of the First or Second Bank. By law, the stock earns a fixed 6 percent dividend. Stockholders elect six of the nine members of a Reserve Bank's board of directors, while the remaining three (including the chairman of each board) are appointed by the Federal Reserve's Board of Governors.

Source 21: *"Somebody had to Save Him from Himself" Los Angeles Times, February 8, 1929* (From **http://americainclass.org/sources/becomingmodern/prosperity/text4/text4.htm**)

"Somebody Had to Save Him from Himself!"

Los Angeles Times, February 8, 1929

Cartoonist: Edmund Gale ■ Dow-Jones closing average, Feb. 7: 305.75.

On February 6, 1929, the Federal Reserve Board warned that banks and stockbrokers were loaning too much money for "speculative credit," i.e., loans for stock purchases by small investors ("the speculation crazy public") who would likely be unable to repay the loans if their stocks failed to rise in value. Soon after, the Federal Reserve Bank of New York reduced the amount it loaned to New York brokers for lending to potential investors. [The "waiter" awaits identification. He is neither the chairman of the Federal Reserve Board in 1929, Roy A. Young, nor the chairman of the Federal Reserve Bank of New York, George L. Harrison.]